

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

**RECEIVED**

In the Matter of:

MAR 01 2004

APPLICATION OF NORTHERN  
KENTUCKY WATER DISTRICT (A) FOR  
AN ADJUSTMENT OF RATES; (B)  
A CERTIFICATE OF CONVENIENCE  
AND NECESSITY FOR IMPROVEMENTS  
TO WATER FACILITIES IF NECESSARY  
AND (C) ISSUANCE OF BONDS

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PUBLIC SERVICE  
COMMISSION

Case No. 2003-0224

**BRIEF OF NORTHERN KENTUCKY WATER DISTRICT**

There are a limited number of issues in this case. The primary purpose of the application is the consolidation of Newport's customer rates into the general rates of the District. The Commission in its final order in Case 2002-00105 directed the District to file this application for that purpose. The second issue involves construction projects related to replacement and improvement of existing infrastructure. As explained in the prefiled testimony of Richard Harrison, the District is continually expanding its facilities to meet the needs of our customers both as to growth in number of customers and growth in demand for water. It is also faced with increasingly stringent water quality standards which necessitate a number of improvements to our treatment plan and related facilities. The total amount of financing and debt service costs are reflected in Mr. Ross's Post Hearing exhibit.

By order of October 1, 2003, the Commission approved all construction projects proposed by the District as ordinary extension projects. However, by order of November

14, 2003, the Commission deferred approval of the financing of the projects pending the final order.

Several questions were raised during this proceeding about the proposed construction of sub district K, Kleete Road/Rice Road. This project is consistent with all prior sub districts approved by the Commission. The purpose of any sub-district is to provide service to areas that otherwise could not be served due to various factors such as location in relation to existing facilities, excessive cost or low customer density. In evaluating the viability of the extension of service the District reviews need for the service, demand from the affected area, cost, funding sources and benefit to the system as a whole. If there is sufficient public demand, and financing can be obtained within the limits of the estimated cost of the project, usually including state or federal loans and grants, the project is subject to approval. However, as part of the final determination of the feasibility of the project, the District reviews the overall hydraulic functioning of the area adjacent to the proposed sub district to determine if there are any additional system benefits that could be achieved from extending the facilities. For example, if the existing primary main serving the nearby area is undersized for future growth as shown in the District's Master Hydraulic Plan, it may be economically sound to upgrade that main as part of the sub district project to avoid a higher cost in the future to make that same upgrade.

As has been the District's practice in these types of extensions, a 12 inch main is generally installed, rather than an 8 inch, to provide for increased demand and to allow for such services as fire protection. The District contributes the cost differential from the

8 to 12 inch mains because the benefit of the larger mains enhances the system rather than just service to the sub district. The reference in Exhibit O, Project 73, Rice Rd./Klette Rd. sub district to strengthen and improve the local transmission and distributions system reflects that policy. Such language and purpose has been a part of the District's sub district extensions from the outset. For example, the sub district C project in Case 2002-00105 referred to upgrade costs for a main extension. The project description of Phase 5 of sub district D, Case No. 2000-00171, exhibit A of the Project Description, has the same descriptive language as the project in this case, that is "strengthen and improve the system and local distribution system to meet population growth and commercial development needs".

The purpose of any sub district project is to provide service to as many residents as possible at the most reasonable cost. If a benefit to the District's hydraulic operations can be achieved at the same time in a more economical manner than otherwise might be possible, that is a benefit which should be pursued

This proposed sub district was developed to extend water service to un-served streets that include Klette Road, Rice Road and Marshall Road. The District's general rate will pay for the upgrade from an 8 inch to 12 inch, because of the hydraulic improvement benefit identified in the District's Master Hydraulic Plan. The existing Ryland Heights area is currently fed by a single eight inch water main which feeds over 200 existing customers. The proposed 12 inch feed from Klette Road will bring a second feed to the Ryland Heights area and will allow capacity for projected 2020 growth along Klette Road, Rice Road and adjacent Sub districts without additional costly improvements. See District's response dated June 18, 2003 Case No. 2000-00171, Phase

5, item 3. Typically an eight inch main is the smallest water main that the District installs except when there is no chance for future extension then the District allows the last 600' as 6 inch. However, due to the hydraulic needs of the District and the anticipation of growth, it normally installs a 12 inch main to provide for growth. The District contributes the difference between the 8 and 12 inch main's cost. The customers are charged only for the 8 inch main and the surcharge is calculated on the cost of the 8 inch main.

The surcharge paid by these customers merely reflects the cost of providing service to them. If the extensions to these customers had been made according to the District's "50 foot policy", the customers would have had to make substantial lump sum payments prior to construction. Most could not afford to do so. The surcharge, in effect, provides an installment payment plan for these customers, which allows the payment of that initial cost over a period of years. Because the surcharge is recalculated each year to reflect additional customers and reduction in debt costs, the financial impact is minimized.

The use of the surcharge allows extension of water to areas that the District would not serve due to excessive costs. By imposing the surcharge, more residents are provided access to potable water, which improves public health and safety and reduces the overall cost of water. Most of the residents in the sub district areas had cisterns or hauled water. The cost of water hauling is far greater than the cost being paid to the District for water. Additionally, the surcharge reflects the Commission's policy of placing the cost of new customers on those customers similar to a system development charge. The general rate

customers benefit from the revenue generated by the sub district customers and from the lower debt cost that results from grants and government subsidized loans.

There is no benefit to either the sub district customers or general customers to combining the sub districts into the general rates. The sub district customers are benefiting from extensions of water mains that would otherwise have not been feasible due to limited number of customers in the affected areas and excessive costs to make the extensions. These customers also benefited from grants or low interest loans available to areas containing a high percentage of low to moderate income families. General rate customers are already benefiting from the additional revenues generated by the sub district customers and are not bearing the total cost of the debt of those extensions. Additionally, it would be unfair to general customers and particularly to other sub district customers to have the debt associated with those sub districts paid by remaining sub district customers. It would also be unfair to the current customers of sub districts to have new customers within those areas to have water at a lower overall cost. That is, the existing customers of the sub districts would be subsidizing the new customers' debt portion of the facilities.

There is no ratemaking or policy reason to change a system that has been in place since 1991 and which has allowed water to be provided to hundreds of residents that did not have access to potable water. If the Commission refuses to continue to allow this successful use of sub districts, there is a very good likelihood that future extensions to economically depressed and unfeasible areas will cease due to the excessive cost of the extensions and the loss of subsidies from government grants and low interest loans. This is not consistent with the District's, County-Judge/Executives' or Governor's efforts

to provide water to every resident. If the Commission revokes its prior authorization for the creation and operation of these sub districts, Northern Kentucky believes that the only equitable, non-discriminatory way to do so is to refund prior surcharge collections. Should the Commission require surcharges to be rolled into general rates, it is not equitable for future customers in these sub district areas to get a free extension when the customers that made the extension possible had to pay a surcharge. In addition, it is not equitable to all other District customers who had to pay for the extension of the main necessary to serve their houses through any method such as the 50 ft. method, assessments and subdivisions to require them to also pay the entire amount of these extensions. The District anticipates major objections from existing customers if the Commission requires them to pay for the entire of cost of these extensions when they had to also bear the cost of the extension that serves their property.

The assumption of the Staff that eliminating the sub districts and including the current debt costs into the general rates will result in only an increase in rates of \$1.98 per year per customer is erroneous. A more realistic analysis of the costs shows that the impact on customers will actually be \$6.67 per month. See attached schedule. See also Harrison's testimony at Transcript of Evidence (TR) pp. 26-27.

One of the puzzling aspects of the Staff's continuing questions about the sub districts is its allowance of similar surcharges for other water districts. For example, in Case 2003-00164, Application of Bullock Pen Water District, the Commission allowed a surcharge to extend facilities. The surcharge applies only to those customers benefiting from the new facilities. The surcharge in the Bullock Pen case is comparable to the ones

imposed by Northern. Except for the fact that Bullock Pen did not establish a sub district, the financing method seems to be identical.

The District strongly urges the Commission to continue its long standing acceptance of the use of sub districts and associated surcharges for the extension of service. The program has provided many residents with water that they otherwise would not have received and there have been no complaints by the customers about the policy or the rates for the service.

**Issues raised by the Attorney General:**

The Attorney General seeks to adjust the proposed revenue requirement by challenging several individual line items. The first is the appropriate amount of debt interest to be used for developing rates. The District believes that the most current debt interest shown on the attached schedule revised by Mr. Ross is the correct amount. See Hearing Exhibit Responses, Exhibit 1. However, as Ms. Howe shows in her revised Schedule C of the Hearing Responses, the impact on the revenue requirement is negligible.

The second adjustment sought by the Attorney General involves water purchased by the District from Newport for the first month of the test period. The District began operating the Newport water works plant in July, 2003. While the District ceased purchasing water from Newport at that time, it incurred the cost of producing a comparable amount of water at the Newport treatment plant. For all months of the test period subsequent to June and continuing now, the District incurs the cost of producing the water that it purchased from Newport. Contrary to the assertion of the Attorney General, that cost of water will not be eliminated. At the hearing, Ms. Howe testified that

the ongoing operations and maintenance costs, chemicals, power, etc. will continue to be expended by the District. (TR pp. 75-76)

If any adjustment is to be made it should only include some imputed "profit" that might have been factored into the wholesale water rate by Newport. She suggested an amount no more than ten percent. (TR p. 76) If the Attorney General's adjustment is accepted, the District will be deprived of the actual costs associated with the production of water at the Newport water plant.

Another issue he raised involves the appropriate recognition of capital expenses and customer connections. The District included 100 percent of the capital expenses related to main extensions, but assumed that only 40 percent of the expected customers would connect to the facilities in the first year. Ms. Howe testified that an extension is installed as a unit, not in small discrete sections that serve customers immediately. Thus, the cost of the extension is incurred in total upon completion. However, it generally takes several years for all potential customers to connect to that extension. (TR p. 67) Therefore, based on her experience and industry standards, only 40 percent of the revenue associated with the projects estimated customers was included in the revenue requirement calculation. The Attorney General presented no evidence that the assumptions of Ms. Howe were incorrect.

Finally, the Attorney General sought to reduce the revenue requirement by an amount he claimed was saved due to the loss of Boone County Water District and the city of Florence as wholesale customers in 2003. He assumed that the amount of water no longer being produced and sold to Boone and Florence should be multiplied by \$.040 per



1000 gallons to determine the amount of expenses saved and, thus, removed from operating expenses.

There are several flaws in his speculation. First, \$0.40 per 1000 gallons is not a current or accurate cost of producing water. As Mr. Barrow and Ms. Howe testified, that number was used for negotiating purposes when the contract to terminate service was being discussed with Boone and Florence. (TR pp. 32, 60) It was not a calculation based on actual costs of treated water. That figure is also based on 1999 assumptions. It is so outdated that it cannot reasonably be applied to the operations today.

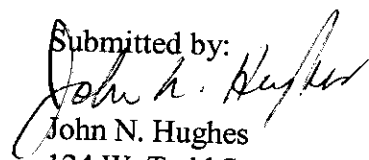
In response to his assertion, the District produced an exhibit at the hearing that shows the current cost of water is \$0.1884 ccf or \$0.252 per 1000 gallons. Applying that cost of water to the actual water sold to Boone and Florence for the applicable period, the resulting savings for variable costs – power, chemicals and sludge – results in an annual savings of \$680,027.00. However, while there is a savings that might be recognized due to a decrease in variable costs. No savings result from fixed costs, because plant has not been decreased, labor has not been reduced, debt has not been reduced, etc. A number of other expenses have increased significantly to offset any Boone/Florence savings.

Mr. Barrow testified that salaries, wages, pensions, and other insurance increased over test year projections by \$677,100. (TR p. 39, Hearing Exhibit 2) Even if the Attorney General is correct in his assertion about some savings from lost sales to Boone and Florence, any such speculative savings are offset by actual, known increases in other expenses.

Based on the evidence presented during the course of this proceeding, the District has justified its proposed levels of revenues and expenses and the resulting rates

necessary to recover those expenses. As the recent experience of the District shows, failure to achieve the proposed revenue requirement only shortens the time until the next rate case is filed.

Submitted by:



John N. Hughes  
124 W. Todd St.  
Frankfort, KY 40601

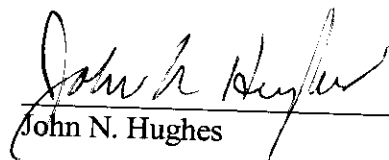
and

Charles H. Pangburn III  
Hemmer, Spoor, Pangburn,  
DeFrank PLLC  
Suite 200  
250 Grandview Dr.  
Ft. Mitchell, KY 41017

Attorneys for Northern  
Kentucky Water District

Certificate:

I certify that a copy of this Brief was mailed to the Attorney General, 1024 Capital Center Drive, Frankfort, KY 40601, the 1<sup>st</sup> day of March, 2003.

  
John N. Hughes



<u>Sub District</u>	<u>Original Cost</u>	<u>Date</u>	<u>2004 Cost</u>
<i>Existing( )</i>			
A	807,938	3/14/1992	1,086,587
B	1,008,262	1/26/1995	1,259,181
C	3,542,000	7/21/2000	3,909,705
D	1,389,575	5/5/2000	1,533,831
R & RL	1,400,000	2/8/1996	1,705,764
<i>New ( )</i>			
E	1,440,000		1,440,000
RF	172,000		172,000
K	626,000		626,000
Unserved Areas	52,358,000		52,358,000
<i>Other</i>			
Past Assessments	<u>2,000,000</u>		<u>2,000,000</u>
<b>Total</b>	<b>64,743,775</b>		<b>66,091,068</b>

#### **New Revenue Bond**

Term 20 years  
Interest Rate 5%  
Bond Issuance Costs 3%

Bond Size 74,352,000  
P&I 5,966,197

Customers (2003) 72,383 PSC 2002 filing escalated 3%  
Growth 3.0% for new areas

**Customer Impact** \$ 6.67 per customer, per month for 20 years